

IOWA STATE UNIVERSITY

Digital Repository

Volume 17 | Number 17

Article 1

9-1-2006

Pension Protection Act of 2006

Roger A. McEowen
Iowa State University

Follow this and additional works at: <http://lib.dr.iastate.edu/aglawdigest>



Part of the [Agricultural and Resource Economics Commons](#), [Agricultural Economics Commons](#), [Agriculture Law Commons](#), and the [Public Economics Commons](#)

Recommended Citation

McEowen, Roger A. (2006) "Pension Protection Act of 2006," *Agricultural Law Digest*: Vol. 17 : No. 17 , Article 1.
Available at: <http://lib.dr.iastate.edu/aglawdigest/vol17/iss17/1>

This Article is brought to you for free and open access by the Journals at Iowa State University Digital Repository. It has been accepted for inclusion in *Agricultural Law Digest* by an authorized editor of Iowa State University Digital Repository. For more information, please contact digirep@iastate.edu.



Agricultural Law Press

Publisher/Editor

Robert P. Achenbach, Jr.

Contributing Editor

Dr. Neil E. Harl, Esq.

* * * *

Issue Contents

Animals

Bull **131**

Horses **131**

Bankruptcy

Federal taxation

Administrative expenses **132**

Refunds **132**

Tax liens **132**

Federal Agricultural Programs

Farm labor **132**

Genetically-modified organisms **132**

PACA **132**

Warehouses **133**

Federal Estate and Gift Taxation

Charitable deduction **133**

IRA **133**

Power of appointment **133**

Valuation **133**

Federal Income Taxation

Alternative minimum tax **134**

Audits **134**

Capital expenses **134**

Court awards and settlements **134**

Disaster losses **134**

Employee benefits **134**

Hybrid vehicle tax credit **134**

IRA **134**

Installment reporting **134**

Interest **134**

Like-kind exchanges **135**

Returns **135**

Safe harbor interest rates

September 2006 **135**

S corporations

Number of shareholders **135**

Sale of residence **135**

Theft losses **135**

Wages **135**

Travel expenses **135**

Patents

Genetically-modified organisms **135**

Product Liability

Silo **136**

Stray voltage **136**

Secured Transactions

Landlord's lien **136**

Agricultural Law Digest

Volume 17, No. 17

September 1, 2006

ISSN 1051-2780

Pension Protection Act of 2006

-by Roger A. McEowen*

Overview. On August 17, President Bush signed into law the Pension Protection Act (Act) of 2006,¹ the first comprehensive pension legislation in more than 30 years. The Act is massive, is designed to strengthen traditional pension plans that cover approximately 44 million Americans (primarily in the manufacturing and other non-service industries) and will certainly make retirement planning for businesses and individuals more complex.² The Act also creates new rules governing charitable donations for businesses and individuals, as well as the operation of charities. In addition, the Act includes numerous miscellaneous provisions and technical corrections.

Pension Provisions. The Act implements a higher limit on the amount of employer contributions that are deductible while generally requiring higher funding levels in order to qualify plan tax status. Under prior law, an employer could deduct plan contributions up to 100 percent of the plan's current liability, with additional contributions subject to a 10 percent excise tax. Under the Act, for plans beginning in 2006 and 2007, the maximum deductible amount is 150 percent of current plan liability.³ Beginning in 2008, deductible contributions may be made up to an amount equal to the excess of the funding target, normal costs, and a "cushion account" equal to 50 percent of target liability plus accountability for projected compensation increases over the value of the plan assets.⁴ Plans with 100 or fewer participants get a break on computing benefit increases for highly compensated employees.⁵ The deduction limit for multiemployer plans increases to 140 percent of current liability.⁶

The Act requires that most pension plans must become fully funded over a seven-year period. The transition from current 90 percent funding to 100 percent full funding is gradual. But, none of the funding rules apply to plan years starting before 2008. After 2007, transition rules apply. Plans that are not fully funded at the start of 2008 may work on meeting interim targets of 92 percent in 2008, 94 percent in 2009, and 96 percent in 2010.⁷ Plans in existence in 2007 that have a pre-funding balance may maintain a funding standard carryover balance until reaching zero, and new plans established after 2007 are ineligible for most of the transition rules.⁸

"At-risk" plans are subject to accelerated contributions.⁹ Companies that are below 80 percent funded cannot use credit balances for funding or making promises to provide enhanced or new benefits. Plans that are less than 60 percent funded will be restricted from offering any lump-sum benefit payments and new accruals are frozen in those plans.

Measuring liabilities is critical to determining full funding under the Act. The Act specifies that the interest rate to be used for 2006 and 2007 can be based on investment-grade corporate bonds.¹⁰ In 2008, the interest rate will be based on a three-segmented yield curve.¹¹

* Leonard Dolezal Professor of Agricultural Law, Iowa State University, Ames, Iowa. Member of the Nebraska and Kansas Bars; honorary member of the Iowa Bar.

Effective for plan years beginning after 2009, the Act provides for a new kind of hybrid pension plan for employers with 500 or fewer employees.¹² The new “DB/K plan” combines a traditional defined benefit pension plan with a 401(k) savings plan.¹³ The plan will provide a lower employer-paid guaranteed lifetime monthly retirement benefit that could be supplemented by voluntary tax deferred contributions by employees.¹⁴ The minimum pension benefit, payable to employees who work three or more years for the employer, will be equal to the greater of one percent of average pay during the last three years of work multiplied by the number of years worked under the plan, up to 20 years, or 20 percent of final average pay.¹⁵ The 401(k) component of the plan requires the employer to match at least 50 percent of an employee’s contributions up to 4 percent of the employee’s salary.¹⁶

The Act also provides liability protection for employers against lawsuits based on age-discrimination for converting a pension plan to a hybrid “cash balance” plan.¹⁷

Retirement Savings Provisions. Under the Act, 401(k), IRA and similar providers may offer personalized investment advice to account holders, but cannot advise employers about which funds and investments to include in their plans.¹⁸

The Act allows taxpayers to deposit their tax refunds into an IRA, and specifies that the Treasury Secretary is to issue an appropriate Form to report such deposits for tax years beginning after 2006.¹⁹ In addition, military reservists called to active duty after September 11, 2001, and before December 31, 2007, for at least 180 days, may make penalty-free early distributions from their IRAs, 401(k)s and similar arrangements.²⁰ Such withdrawals may be re-contributed within two years after the end of active duty to avoid income tax on the distributions.²¹

Under the Act, the Treasury is to issue rules within 180 days of enactment that allow 401(k) plan withdrawals for hardships and unforeseen financial emergencies with respect to any person who is listed as a beneficiary under the plan.²²

Under prior law, a taxpayer could roll over a deceased spouse’s interest in a qualified retirement plan, government plan or tax sheltered annuity into an IRA with distributions only taxed as normal distributions are taken. The Act extends this treatment to non-spouse beneficiaries.²³

The Act allows direct rollovers (rather than two-step rollovers) from a qualified retirement plan, tax-sheltered annuity or governmental plan directly to a Roth IRA and will treat it as a Roth conversion if all other conversion qualifications are met.²⁴

Permanency of EGTRRA Provisions. The Act repeals the sunset provisions of EGTRRA applicable to retirement savings. Provisions made permanent include:

- Ceiling on IRA contributions (\$4,000 in 2006; \$5,000 in 2008; inflation adjusted thereafter);²⁵
- Higher dollar limits on defined contribution plans (\$44,000 in 2006); elective deferrals (including \$15,000 in 2006 for 401(k) plan deferrals);²⁶ 457 plan deferrals (\$15,000 in 2006); SIMPLE plan contributions (\$10,000 in 2006);²⁷
- Increases in the annual benefit limit under a defined benefit plan (\$175,000 for 2006);²⁸
- Permanent catch-up contributions for older workers (\$1,000

after 2005 for IRAs (not adjusted for inflation), \$2,500 for SIMPLE plans, \$5,000 for 401(k) plans (adjusted for inflation in \$500 increments));²⁹

- Higher deductible amounts for employer contributions to employee retirement plans (inflation-adjusted to \$220,000 in 2006);³⁰
- Roth 401(k)s and 403(b)s;³¹
- Start-up credit for new small employer-sponsored plans;³²
- Defined benefit plan limits;³³
- Saver’s credit (with gross income amounts used to compute the amount of the credit indexed for inflation beginning in 2007; however the credit itself is not adjusted for inflation);³⁴
- I.R.C. §529 plans.³⁵

Charitable Donation Provisions. Effective after August 17, 2006, the Act eliminates a tax deduction for used clothing and household items unless the items are in “good” condition.³⁶ The Act also requires that cash donations, *of any amount*, must be substantiated either by a cancelled check, bank record or written substantiation from the charity indicating the amount of the contribution, the date the contribution was made and the name of the charity.³⁷

The Act allows taxpayers to make tax-free distributions from IRAs (both traditional and Roth) for charitable purposes through 2007, with a maximum annual cap of \$100,000.³⁸

The Act also extends through 2007 the food donation rules contained in the Katrina Relief Act of 2005 for partnerships, S corporations and other business entities.³⁹ Likewise, the Act extends through 2007 the enhanced deduction for books donated to public schools by C corporations.⁴⁰

For 2006 and 2007 only, the Act raises the deduction limits for qualified conservation easements from 30 percent to 50 percent of adjusted gross income.⁴¹ For a donor that is a “qualified farmer or rancher”⁴² the deduction limit is 100 percent provided the donated property remains available for agricultural production.⁴³

Effective for contributions through 2007, the reduction in shareholder stock basis in an S corporation due to a charitable contribution by the corporation equals the shareholder’s pro rata share of the adjusted basis of the contributed property.⁴⁴

The Act also increases federal oversight of charitable organizations in certain areas, and includes numerous miscellaneous provisions applicable to charities, modifies the thresholds for substantial and gross valuation misstatements, and imposes new penalties on appraisers who provide bogus appraisals.⁴⁵

Footnotes

¹ H.R. 4, P.L. 109-280.

² The Labor Department estimates that approximately 30,000 pension plans are presently underfunded by \$450 billion.

³ Act, Sec. 801(d), *amending* I.R.C. § 404(a)(1)(D), clause (i).

⁴ Act, Sec. 801(a), *amending* I.R.C. § 404.

⁵ Act, Sec. 801(a)(4).

⁶ Act, Sec. 802(a), *amending* I.R.C. § 404(a)(1)(D), effective for years beginning after 2007.

⁷ Act, Sec. 112, *amending* I.R.C. § 430.

⁸ *Id.* However, Delta and Northwest airlines are allowed 17 years to fully fund their plans. Other airlines get 10 years to fully fund plans. Act, Sec. 402, effective for plan years after Aug. 17,

2006.

⁹ An “at-risk” plan is (1) less than 80 percent funded, without regard to at-risk liabilities; and (2) less than 70 percent funded counting at-risk liabilities.

¹⁰ Act, Sec. 401.

¹¹ Act, Sec. 302, *amending* 29 U.S.C. § 1055(g)(3) and I.R.C. § 417(e)(3), effective for plan years beginning after 2007.

¹² Act, Sec. 903, *amending* I.R.C. § 414.

¹³ Under current law, employee contributions to traditional pension plans are not tax deferred. Thus, few pension plans require or permit employee contributions. Instead, many employers supplement their pension plans with separate 401(k) plans which permit employees to defer taxes on their contributions.

¹⁴ Act, Sec. 903, *amending* I.R.C. § 414.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ The conversion impacts older employees to a greater degree inasmuch as an older employee has fewer years to build up savings. But, an employer’s alternative to switching to a hybrid plan may be to leave employees with no pension plan at all.

¹⁸ Act, Sec. 601, *amending* 29 U.S.C. § 1108(b), effective for advice provided after December 31, 2006.

¹⁹ Act, Sec. 830. Also, in I.R. 2006-85 (May 31, 2006), IRS announced that, effective January 2007, taxpayers could split their refunds and deposit them in as many as three different bank accounts. IRS will issue new Form 8888 for taxpayers to use to split their refunds in time for the 2007 filing season.

²⁰ Act, Sec. 827, *amending* I.R.C. § 72(t)(2), effective for distributions after September 11, 2001.

²¹ *Id.*

²² Act, Sec. 826. The rules are to be consistent with hardship withdrawals now allowed for spouses and I.R.C. § 152 dependents. *Id.*

²³ Act, Sec. 829, *amending* I.R.C. § 402(c), applicable for distributions after 2006.

²⁴ Act, Sec. 824, *amending* I.R.C. § 408A(e), effective for distributions after 2007.

²⁵ Act, Sec. 811.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ Act, Sec. 812, *eliminating* I.R.C. § 25B(h).

³⁵ Act, Sec. 1304.

³⁶ The Act does not define “good condition.”

³⁷ Act, Sec. 1217, *amending* I.R.C. § 170(f), effective for tax years beginning after Aug. 17, 2006.

³⁸ Act, Sec. 1201, *amending* I.R.C. § 408(d). The provision is inapplicable for any portion of a withdrawal that would have been otherwise taxable. *Id.*

³⁹ Act, Sec. 1202, *amending* I.R.C. § 170(e)(3)(C)(iv), effective for contributions made after 2005 and before 2008.

⁴⁰ Act, Sec. 1204, *amending* I.R.C. § 170(e)(3)(D)(iv), effective for contributions made after 2005 and before 2008.

⁴¹ Act, Sec. 1206, *adding* I.R.C. § 170(b)(1)(E)(i), and redesignating existing paragraphs (E) and (F) as (F) and (G), effective for tax years through 2007.

⁴² The term “qualified farmer or rancher” means a taxpayer whose gross income from the trade or business of farming as defined by I.R.C. § 2032(e)(5) exceeds 50 percent of the taxpayer’s gross income for the tax year.

⁴³ Act, Sec. 1206, *adding* I.R.C. § 170(b)(1)(E)(iv), and redesignating existing paragraphs (E) and (F) as (F) and (G), effective for tax years through 2007.

⁴⁴ Act, Sec. 1203, *amending* I.R.C. § 1367(a)(2), effective for contributions made in tax years after Dec. 31, 2005, and before January 1, 2008.

⁴⁵ Act, Sec. 1219, *amending* I.R.C. §§ 6662, 6664, and adding I.R.C. § 6695A, effective for returns filed and appraisals prepared with respect to returns or submissions filed after Aug. 17, 2006.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ANIMALS

BULL. The plaintiffs were injured when their car struck the defendant’s bull on a highway near the defendant’s farm. The trial court granted summary judgment for the defendant because of absence of any evidence of negligence by the defendant, particularly in maintaining the fences. The appellate court stated that the duty of an animal owner was to prevent an animal from escaping onto a highway if the owner could reasonably anticipate that the animal could escape and stray onto a highway. The court noted that the defendant had admitted that the bull involved had escaped at least once before and that the defendant did not check

on the bull during the day of the accident. The court also noted that other factors should be considered in determining whether the defendant had acted reasonably, including the proximity of the highway, the amount of traffic on the highway, the time of day and other surrounding conditions. The court reversed the grant of summary judgment, holding that sufficient issues of fact remained to be determined before the defendant could be considered, as a matter of law, to have acted reasonably in the methods chosen to prevent the bull from escaping. The plaintiffs also argued that the doctrine of *res ipsa loquitur* should apply in the case to impose liability on the defendant; however, the appellate court refused to rule on this issue until the trial court had an opportunity to rule on remand of the case. **Casillas v. Schubauer, 714 N.W.2d 84 (S.D. 2006).**

HORSES. The plaintiff was injured while riding a horse owned